

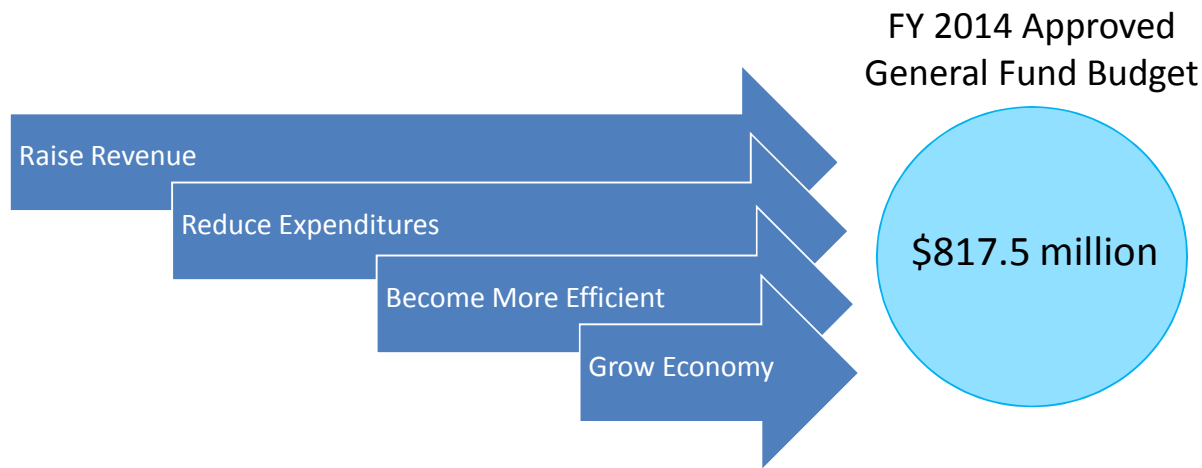
Real Estate Tax Sustainability

City Council Retreat
September 23-24, 2013

Presentation Overview

- The purpose of this briefing is to provide information for a discussion on the sustainability of real estate revenues
- The presentation is organized as follows:
 - Overview of the real estate tax
 - Guideline for sustainability of real estate revenue
 - Case study: City of Hampton
 - Analysis of fiscal impact on Norfolk

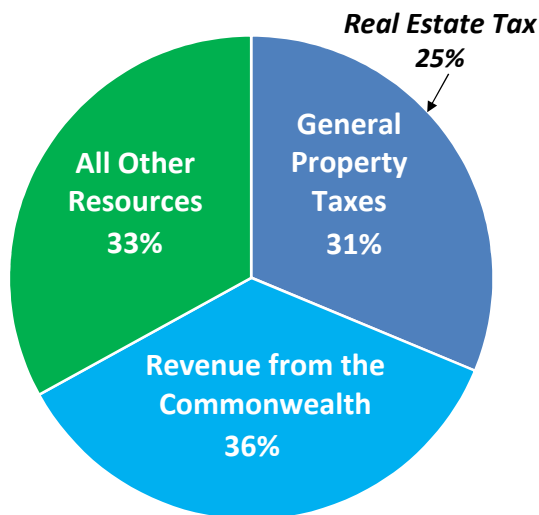
FY 2014 Approved General Fund Budget



Overview of the real estate tax

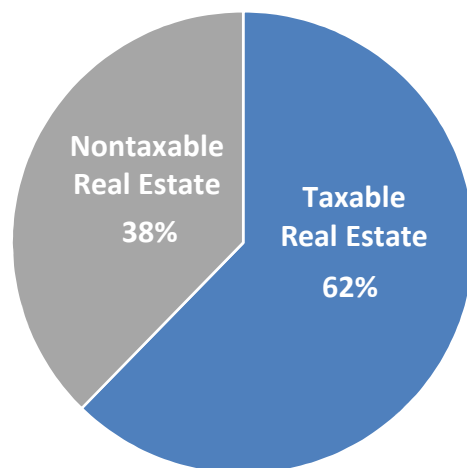
Real estate is a significant source of local revenue, but not all of it is taxable

**City of Norfolk
FY 2014 General Fund
Revenue**



**City of Norfolk Real Estate
Taxable vs. Nontaxable**

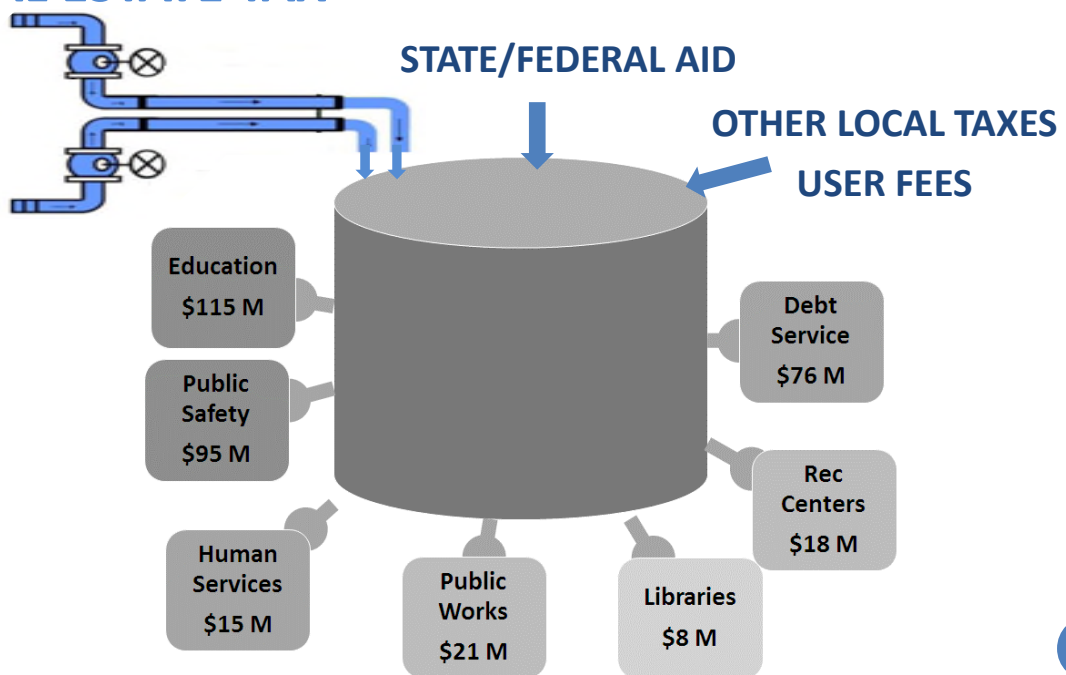
*Potential revenue loss from
nontaxable real estate \$122 million*



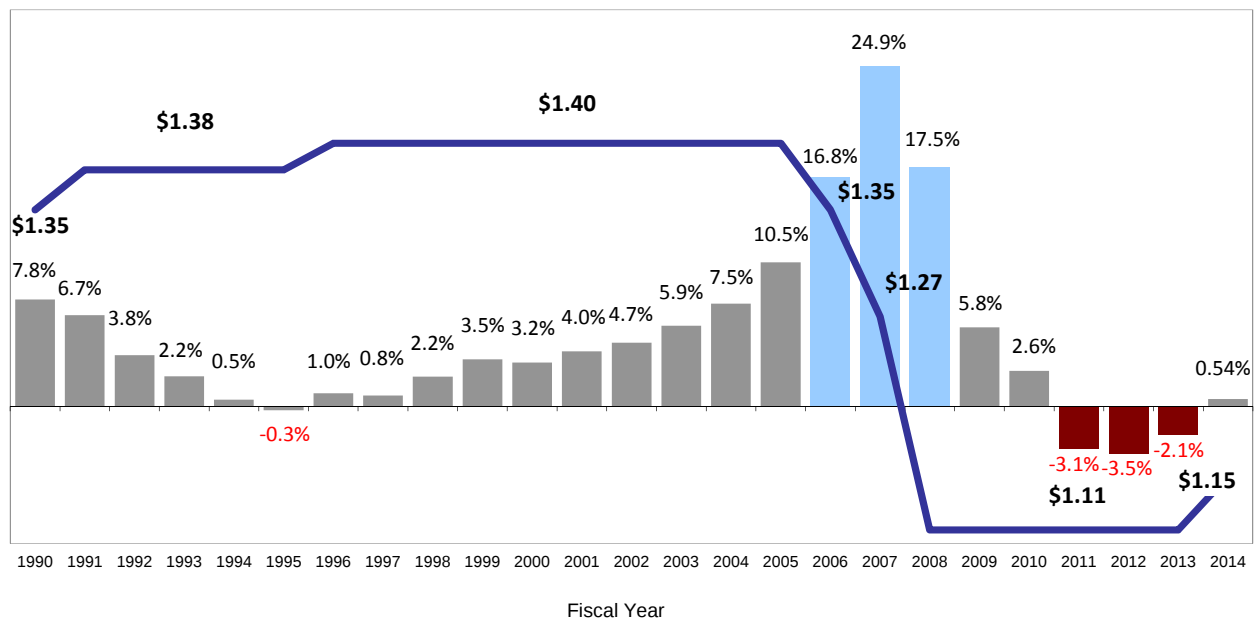
Potential revenue loss based on the real estate tax rate of \$1.15 per \$100 of assessed value. Assessed values are preliminary, pending the release of the City Assessor's Annual Report for FY 2014.

Real estate and other resources fund basic services

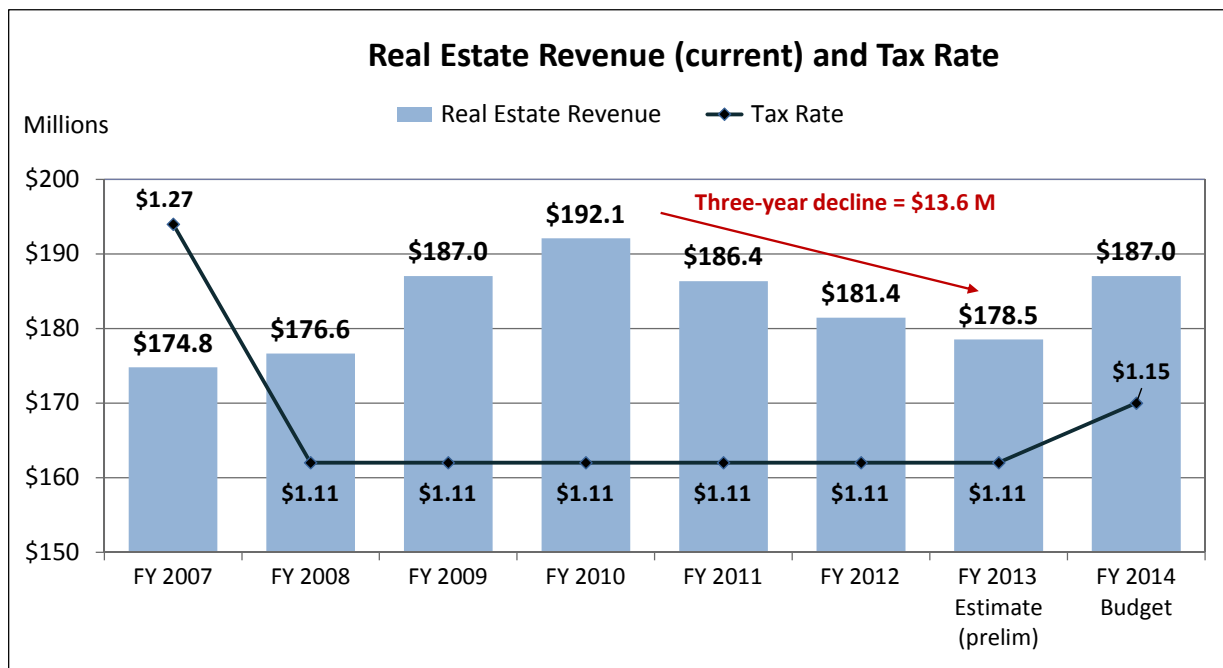
REAL ESTATE TAX



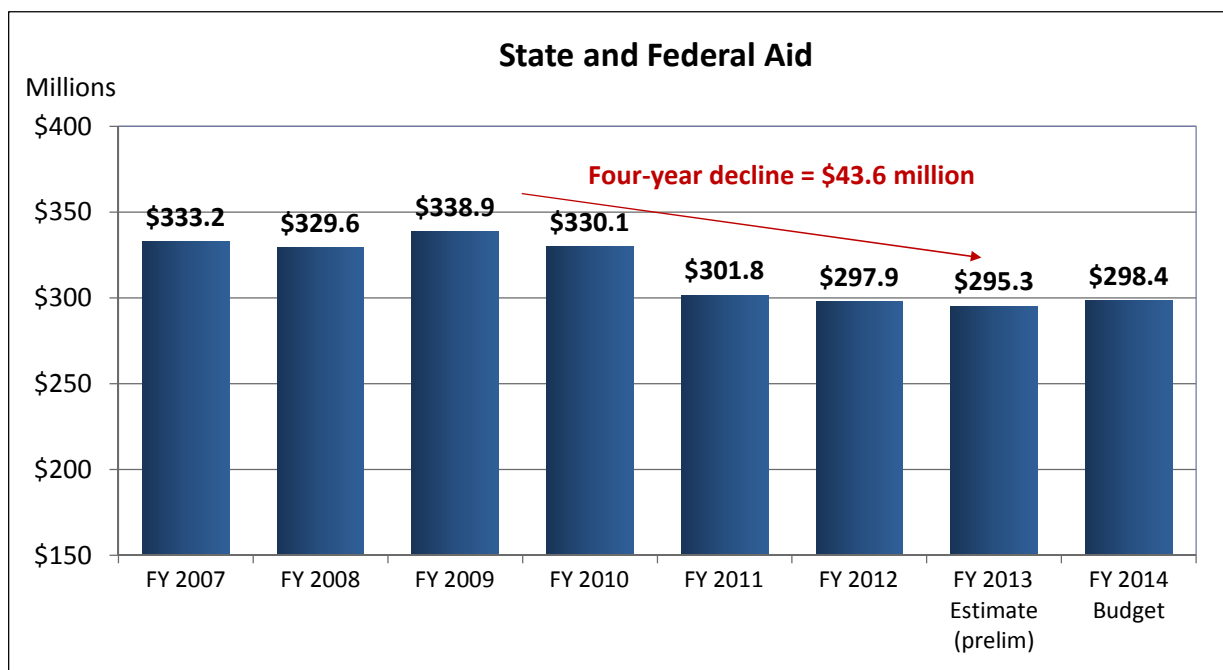
Real estate assessments impacted by the housing market decline



Real estate revenue declined with the tax rate remaining at \$1.11



State and federal aid also declined



Legal constraints on generating revenue

- Virginia is a *Dillon Rule* state
- Dillon's Rule is used in interpreting state law when there is a question of whether or not a local government has a certain power
 - Dillon's Rule narrowly defines the power of local governments
 - Dillon's Rule restricts the power and flexibility which local governments have to address their needs

Source: Clay L. Wirt. "Dillon's Rule." *Virginia Town & City*, vol. 24, no. 8, August 1989.

Guideline for sustainability of real estate revenue

Real estate sustainability

- Due to the economic and housing market downturn, Norfolk revenue declined significantly
- Moreover, the Dillon Rule restricts Virginia localities' ability to generate new revenue
- Some localities have a policy/guideline that ties real estate revenue to an index, which could be designed to ensure sustainability of real estate revenue
 - For example, City of Hampton Tax Revenue Guideline, which will be discussed in the next section

Real estate sustainability (continued)

- Parameters commonly used to index revenue include inflation, income, and population

Index	Significance for Revenue Growth
Inflation	Revenue should keep up with the increase in the cost of providing services
Resident Income	Income reflects “ability to pay” for services
Population	Revenue should keep up with population growth, since the demand for services typically increases as population grows

- However, this does not address the steep decline in state and federal aid, which is also a substantial revenue source for Norfolk

City of Hampton Tax Revenue Guideline

City of Hampton

- Tax Revenue Guideline:
 - When property assessments increase:
 - The Real Estate tax rate should be adjusted downward annually based on a minimum assessment increase of the equivalent of at least one penny on the tax rate as compared to the previous fiscal year
 - Real estate tax revenue growth (net of new construction) tied to percentage increase in inflation (CPI-U) or resident income growth, whichever is greater
 - When budgetary needs require growth in real estate tax revenue to be above the guideline, the City Manager/Council shall explain the budget driving forces so that residents may have a clear and concise understanding of the need to deviate from the guideline

City of Hampton (continued)

- Tax Revenue Guideline:
 - When property assessments decrease:
 - The Real Estate tax rate should be adjusted upwards annually based on a minimum assessment decline of the equivalent of at least one penny on the tax rate as compared to the previous fiscal year
 - Additional factors to be considered include cost pressures and resident income growth.
 - Flexibility will be provided to the governing body regarding the application of this tax rate factor

City of Hampton (continued)

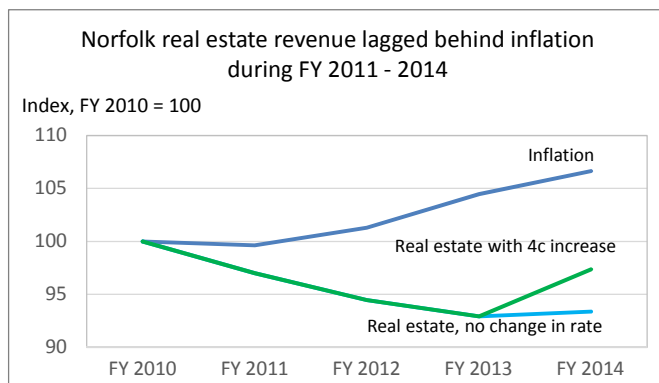
- Tax Revenue Guideline:
 - When property assessments increase or decrease:
 - At a minimum, all revenues and fees should be examined each year to encourage diversity and less reliance on real property revenues during economic declines

Analysis of Fiscal Impact on Norfolk

Overview of analysis

- This section of the presentation discusses how Norfolk real estate revenue growth compared to the following indices:
 - Inflation
 - Average resident income
 - Population
- The potential revenue impact is also provided if real estate revenue had been tied to these indices during the following periods:
 - **FY 2011 - FY 2014**, when real estate revenue was declining; and
 - **FY 2014** (a look back on the development of current budget)

Indexing to inflation/Consumer Price Index (CPI) change



Indexing real estate revenue to inflation beginning in FY 2015, it would take about 1-2 years for real estate revenue to be back to the FY 2010 level, assuming no change in real estate assessments

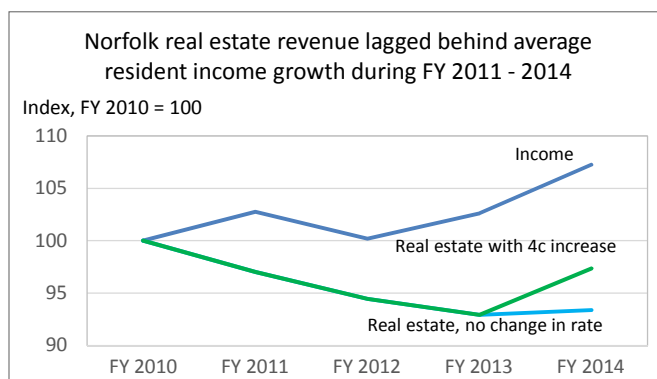
Comparison of Annual Percent Change in Inflation with Norfolk Real Estate Revenue (current)

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2010 - 2014
CPI-U Annual Percent Change	-0.4%	1.6%	3.2%	2.1%	6.6%
Real Estate (current) Annual Percent Change	-3.0%	-2.6%	-1.6%	0.5%* 4.8%**	-6.6%* -2.6%**
Real Estate Tax Rate indexed to inflation (annual increase in tax rate in parenthesis)	\$1.14 (3¢)	\$1.19 (5¢)	\$1.245 (5.5¢)	\$1.263 (1.8¢)	Total = 15.3 cents

* Excludes growth/impact from the four cent rate increase from \$1.11 to \$1.15.

** Includes growth/impact from the four cent rate increase from \$1.11 to \$1.15.

Indexing to average resident income growth



Indexing real estate revenue to average resident income growth, it would take about 1-2 years for real estate revenue to be back to the FY 2010 level, assuming no change in real estate assessments.

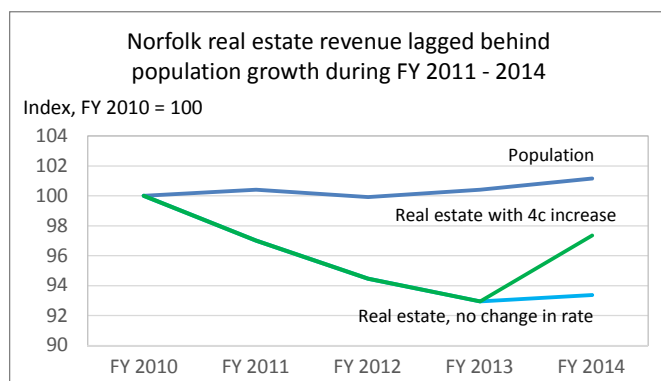
Comparison of Annual Percent Change in Average Resident Income with Norfolk Real Estate Revenue (current)

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2010 - 2014
Average Resident Income Annual Percent Change	2.8%	-2.5%	2.4%	4.5%	7.3%
Real Estate (current) Annual Percent Change	-3.0%	-2.6%	-1.6%	0.5%* 4.8%**	-6.6%* -2.6%**
Real Estate Tax Rate indexed to average resident income (annual increase in tax rate in parenthesis)	\$1.18 (7¢)	\$1.18 (0¢)	\$1.22 (4¢)	\$1.27 (5¢)	Total = 16 cents

* Excludes growth/impact from the four cent rate increase from \$1.11 to \$1.15.

** Includes growth/impact from the four cent rate increase from \$1.11 to \$1.15.

Indexing to population growth



Indexing real estate revenue to population growth, it would take about 6-7 years for real estate revenue to be back to the FY 2010 level, assuming population grew at the 10-year average and no change in real estate assessments.

Comparison of Annual Percent Change in Population with Norfolk Real Estate Revenue (current)

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2010 - 2014
Population Annual Percent Change	0.4%	-0.5%	0.4%	0.7%	1.2%
Real Estate (current) Annual Percent Change	-3.0%	-2.6%	-1.6%	0.5%* 4.8%**	-6.6%* -2.6%**
Real Estate Tax Rate indexed to inflation (annual increase in tax rate in parenthesis)	\$1.15 (4¢)	\$1.18 (3¢)	\$1.20 (2¢)	\$1.20 (0¢)	Total = 9 cents

* Excludes growth/impact from the four cent rate increase from \$1.11 to \$1.15.

** Includes growth/impact from the four cent rate increase from \$1.11 to \$1.15.

Indexing FY 2014 real estate tax revenue (A look back with the 4¢ increase)

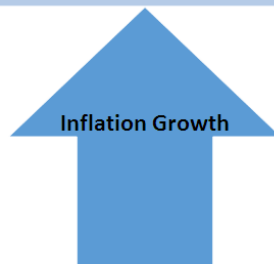
- The table below recaps the total increase in the tax rate needed in FY 2014 to make up for the growth in inflation, income and population during the FY 2010 – 2014 period
 - The table also shows the tax rate increase needed to get back to the level of real estate revenues in FY 2010 (pre-recession level)

Index	Real Estate Tax Rate Increase with Indexing ("catch up")	Real Estate Tax Rate with Indexing ("catch up")
Inflation (CPI-U) Growth	15.3¢	\$1.263
Average Resident Income Growth	16.0¢	\$1.27
Population Growth	9.0¢	\$1.20
To Return to FY 2010 Revenue	7.6¢	\$1.186

Norfolk option: When there is assessment growth

- When assessments are **increasing**, Norfolk real estate revenue growth from the previous year's revenue should not be below the three year average increase in inflation, not to exceed five percent

Five Percent Growth Ceiling



- When assessments are **declining**, the minimum (“floor”) should be to maintain revenue neutrality
 - Real estate revenue should be at least the same as the previous year's revenue

Norfolk option (continued)

- Under this option, real estate revenue growth would, at a minimum, keep up with general cost of living increases
- Revenue used above the limit (“ceiling”) would need to be justified
- Guideline would be revisited when real estate revenue has reached pre-recession level (FY 2010)

Issues to consider

- When real estate revenue was growing at double-digit rates, the city reduced tax rates to provide relief to taxpayers
- Indexing could provide sustainability of real estate revenue for funding basic services when assessments are falling
 - However, this would require raising the real estate tax rate
- Indexing could be implemented until real estate revenue has at least reached pre-recession level (FY 2010), if assessments do not grow quickly enough

Council Strategy Discussion and Direction
